Vol 3

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 527

CARL M. LOEB, Jr.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 528

HENRY A. LOEB,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

Arthur B. Hyman,
Counsel for Petitioners.

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PETITION FOR WRITS OF CERTIORARI.

May it Please the Court:

The petition of Carl M. Loeb, Jr., and Henry A. Loeb respectfully shows to this Honorable Court:

A.

Summary Statement of the Matter Involved.

These proceedings, involving the same questions of law, were consolidated for hearing and decision before the

United States Board of Tax Appeals, and the records and briefs before the Circuit Court of Appeals were likewise consolidated for argument before that court.

The case of Carl M. Loeb, Jr., involves alleged deficiencies in income taxes for the years 1933 and 1934 in the sums of $2,611.75 and $7,006.99, respectively.

The case of Henry A. Loeb involves an alleged deficiency for the year 1934 in the sum of $5,915.01.

The claimed deficiencies result from a determination by the Commissioner that the income of a trust created by the petitioners was taxable to them as grantors under Section 167 (a) (2) of the Revenue Acts of 1932 and 1934 because, in the discretion of someone held by him to have no substantial adverse interest, it might have been distributed to them, regardless of the fact that it neither was distributed to nor accumulated for them nor applied nor applicable to the discharge of their obligations, and that the distribution thereof was not subject to their control.

The trust instrument involved conveyed absolutely to the trustee the property therein mentioned and described, with no power reserved in the grantors over the *corpus* or income, with no provision for its application to the discharge of any obligations of the grantors, with no power to compel the resignation of the trustee or to substitute others or to appoint a successor upon the resignation or incapacity of the trustee, with no power over investment and none over administration, and with no power to revoke.

The Court of Appeals, in affirming the Board of Tax Appeals, which, in turn, sustained the determination of the Commissioner, holds that the words "substantial adverse interest" in the disposition of the income mean a direct interest in such income, and that the trustee's power to distribute the income to his wife, to whom he owed the duty of support, to the exclusion of the grantors, was not a direct interest in its disposition.

The questions involved are as follows:

1. Does a trustee to whom property is irrevocably conveyed, with sole and absolute discretion to distribute the income therefrom in such shares and proportions as he might designate, and to such of the beneficiaries named in the trust instrument as he might appoint, consisting of his wife, to whom he owes the duty of support, and four adult children, two of whom are the grantors, have an interest in the disposition of such income substantially adverse to that of the grantors?

2. Is section 167(a)(2) of the Revenue Acts of 1932 and 1934 constitutional if construed to permit the taxation to the grantors of income of a trust which was neither distributed to nor accumulated for them, nor applied nor applicable to the discharge of their obligations, and the distribution of which was not subject to their control?

The material facts, briefly stated, are as follows:

Prior to 1918, Carl M. Loeb, petitioners' father, had created a trust under which he and his wife, Adeline L. Loeb, were trustees, for their four children, John L., Margaret L., and the petitioners. Each of the children was granted an undivided one-fourth interest in the corpus of the trust, which was distributable to such child upon arrival at the age of forty, or, in the discretion of the trustees, after arrival at the age of twenty-one (R. 54).

In 1928, after petitioners had arrived at the age of twenty-one, Carl M. Loeb told them that the property held in trust for their sister and brother, Margaret L. and John L., had been distributed several years before and that subsequent to such distribution the property remaining in trust for petitioners had so enhanced in value and had assumed such a large proportion of the value of the estate as a whole that he felt it was only fair that their mother, sister and eldest brother should participate in it.

He therefore proposed that petitioners take their distributive shares of the trust at that time and create a new trust for the benefit of their mother, sister, eldest brother and themselves (R. 54).

The petitioners acceded to this request, whereupon the old trust was terminated (R. 54) and, by instrument executed on January 16, 1929, petitioners conveyed the aforesaid distributive shares to their father, Carl M. Loeb, as trustee, in trust, to receive and collect the income therefrom and to pay the same over, on the 31st day of December in each year during the continuance of the trust, to such and so many of the following beneficiaries, or the survivors of them, and in such shares and proportions as said trustee, so long as he should remain such, in his absolute discretion should from time to time designate and appoint, namely:

Adeline L. Loeb, wife of the trustee and mother of the grantors;

Margaret L. Kempner, daughter of the trustee and sister of the grantors;

John L. Loeb, son of the trustee and brother of the grantors;

Carl M. Loeb, Jr., Henry A. Loeb, grantors;

and any one or more of the surviving descendants of any of the four last named beneficiaries who should die during the continuance of the trust (R. 44-51).

The new trust was irrevocable and was to continue until the death of Carl M. Loeb, when the corpus was to be divided equally among all of the above named beneficiaries, except Adeline L. Loeb, the wife of the trustee.

Successor trustee or trustees could be appointed under certain circumstances by a majority of the adult beneficiaries. Such successor or successors had no discretion as to the distribution of the income but were required to distribute the same annually, in equal proportions, among the aforementioned five beneficiaries.

At the time of the creation of the trust, the grantors and each of the other beneficiaries were over the age of twenty-one (R. 57).

Carl M. Loeb, the trustee, was possessed of substantial resources and maintained his family upon a scale of living consistent with his means. He and his wife lived together in one household and their living and household expenses exceeded \$25,000 per annum, exclusive of rent. The distributions received by his wife, Adeline L. Loeb, from the said trust, together with the income from her separate estate, were used by her to defray these expenses (R. 42). She was possessed of a separate estate created for her by her husband, but it does not appear that such estate was substantial (R. 41).

During the year 1934, one of the taxable years in question, normal income from her separate estate was \$6,184.46, against which she had capital losses of \$5,324.25, so that her actual net income from her separate estate was only \$860.21 (R. 43). However, she received a distribution of \$24,892.22 from the trustee during that year, making her total income for 1934 \$25,752.43, approximately the amount which she needed to defray the household and living expenses of her husband and herself (R. 43).

Distributions by the trustee in each of the years that the trust was in existence were as follows:

For 1929, to John L. Loeb, \$39,791.05; to Henry A. Loeb, \$79,582.11, and to Carl M. Loeb, Jr., \$79,582.11; in 1930, the entire income of the trust, to wit, \$40,560.90, to Adeline L. Loeb, the wife of the trustee; in 1931, there was no income and no distribution; in 1932, the entire income of the trust, to wit, \$15,362, to Adeline L. Loeb; in 1933, there was no income and no distribution, but due to limitations on the deduction of capital losses, there was taxable income which has been included by the Commissioner in the income of the petitioners; for 1934, \$24,892.22 to Adeline L. Loeb; \$20,000

to Margaret L. Kempner, and $5,000 to Henry A. Loeb, one of the grantors. Carl M. Loeb, Jr., the other grantor, received nothing. In 1935, the income was distributed in three equal parts of $52,550.92 each to Adeline L. Loeb, the trustee's wife, to Margaret L. Kempner and to Henry A. Loeb (R. 59).

Income was reported by the recipients thereof and the tax duly paid thereon by them.

B.

Reasons Relied On for the Allowance of the Writs.

1. The court below has held that Carl M. Loeb, the trustee, did not have a substantial adverse interest, as the term is used in Section 167 of the Revenue Acts of 1932 and 1934, in the income of the trust in question because he had no direct interest therein.

This narrow definition of a substantial adverse interest is in direct conflict with the determination of the Circuit Court of Appeals for the Eighth Circuit in *Helvering* v. *Hormel,* 111 F. (2d) 1 (certiorari granted Oct. 14, 1940), and of the Circuit Court of Appeals for the Third Circuit in *Savage* v. *Commissioner,* 82 F. (2d) 92.

In *Helvering* v. *Hormel,* a mother, to whom trust income was paid as guardian for the use of her children, was held to have a substantial adverse interest in the trust income under section 167 of the Revenue Act of 1934, and in *Savage* v. *Commissioner,* a father, receiving trust income for the use of his children, was held to be a beneficiary of the trust within the intendment of section 166 of the Revenue Act of 1928. In neither of these cases was there a direct interest in the trust income as required by the determination of the Court of Appeals in the instant case.

2. The decision below is also in conflict with *Raoul H. Fleischmann* v. *Commissioner,* 40 B. T. A. 672 (in which

the Commissioner has announced his acquiescence), where a mother was held to have a substantial adverse interest in the income of a trust providing for the support of her children although she herself had no direct interest therein.

It is likewise in conflict with *Olive H. Prouty* v. *Commissioner,* 41 B. T. A. 277, and *Freda R. Caspersen* v. *Commissioner,* 40 B. T. A. 758, in each of which a parent was held to have a substantial adverse interest in trust income to be distributed to his or her children although possessing no direct interest therein.

These cases were determined by the Board of Tax Appeals subsequent to the Board's determination in the instant cases, but no attempt was made to reconcile the conflicting views expressed by the Board. *Olive H. Prouty* v. *Commissioner* is on appeal to the Circuit Court of Appeals for the First Circuit and has already been submitted for determination, and *Freda R. Caspersen* v. *Commissioner* is on appeal to the Circuit Court of Appeals for the Third Circuit and shortly will be submitted for determination.

3. This Court has not passed upon the constitutionality of section 167 of the Revenue Acts of 1932 and 1934, as re-enacted in the same numbered sections of the Internal Revenue Code, construed so as to tax to the grantor of a trust income which was neither distributed to nor accumulated for him nor applied nor applicable to the discharge of his obligations, and the distribution of which was not subject to his control. The determination of the Court of Appeals that, as so construed, the section is constitutional, is in conflict with fundamental constitutional doctrines enunciated by this Court in *Heiner* v. *Donnan,* 285 U. S. 312; *Hoeper* v. *Tax Commission,* 284 U. S. 206; *Schlesinger* v. *Wisconsin,* 270 U. S. 230, and *Bowers* v. *Kerbaugh-Empire Co.,* 271 U. S. 170. The existence of this taint was recognized in the dissenting opinion in *Charles H. Mott* v. *Commissioner,* 30 B. T. A. 1040.

4. Certiorari has been granted in *Helvering* v. *Hormel, supra,* which will bring before this court for consideration for the first time the meaning of the term "substantial adverse interest", as used in the statutes*, and the constitutionality of a Congressional attempt, if the statutes be so construed, to tax to the grantor of a trust income which has been irrevocably transferred and over which he retains no control.

Like questions are involved in these cases, and it is respectfully suggested that certiorari should be granted here so that a complete presentation of the subject may be made. Furthermore, unless certiorari is granted, the judgments of the Court of Appeals will become final before this Court can reach a conclusion in the *Hormel* case, thus leaving the petitioners without remedy.

5. In the interest of administrative efficiency in the collection of revenue, the questions presented should be speedily resolved. They are presented here in simple and direct form.

Wherefore, petitioners respectfully pray that writs of certiorari be issued out of and under the seal of this Honorable Court, directed to the Court of Appeals for the Second Circuit, commanding that court to certify and send to this Court, for its review and determination on a day certain therein to be named, a full and complete transcript of the record and of proceedings in those cases, numbered and entitled on its docket Nos. 292-293, *Carl M. Loeb, Jr.* v. *Commissioner of Internal Revenue,* and *Henry A. Loeb* v. *Commissioner of Internal Revenue,* and that said judg-

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* In the *Hormel* case, the Circuit Court agreed with the Board that the petitioner was not taxable under Section 167, but reversed the determination of no deficiency on the ground that he was taxable under Section 22(a). The Commissioner, however, will undoubtedly seek to sustain the judgment below by relying not only on Section 22(a) but on Section 167.

ments of the Court of Appeals for the Second Circuit may be reviewed by this Honorable Court, and that these petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioners will ever pray.

Carl M. Loeb, Jr., and
Henry A. Loeb,
By Arthur B. Hyman,
Counsel for Petitioners.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I.

The Opinions of the Courts Below.

The opinion of the Circuit Court of Appeals for the Second Circuit was rendered on July 20, 1940. It is reported in 113 F. (2d) 664, and is to be found on pages 94 to 98 of the record herein.

The opinion of the Board of Tax Appeals is reported in 40 B. T. A. 516, and appears on pages 21 to 28 of the record herein.

II.

Jurisdiction.

1. The statutory provision believed to sustain jurisdiction is Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (c. 229, sec. 1; 43 Stat. 938).

2. The judgments sought to be reviewed were entered on August 5, 1940 (R. 98, 99).

3. The proceedings in which review is sought were initiated in the United States Board of Tax Appeals and were consolidated for hearing before the Board and for argument in the Circuit Court of Appeals. They involve the liability of the petitioners for income taxes under section 167(a)(2) of the Revenue Acts of 1932 and 1934 on income of a trust created by them. Deficiency orders were entered and petitions for review duly filed in the Circuit Court of Appeals for the Second Circuit which affirmed the determination of the United States Board of Tax Appeals.

4. Cases believed to sustain jurisdiction are:
   Helvering v. *Leonard,* 310 U. S. 80;
   Anderson v. *Helvering,* 310 U. S. 404.

III.

Statement of the Case.

A full statement of the case has been given under heading "A" in the petition and in the interest of brevity is not repeated.

IV.

Specification of Errors.

The Circuit Court of Appeals for the Second Circuit erred in the following respects:

1. In holding that Carl M. Loeb, the trustee under the deed of trust involved in these proceedings, had no interest in the disposition of the income of said trust substantially adverse to that of the petitioners.

2. In determining that the petitioners were taxable upon the income of said trust notwithstanding that the distribution of such income was not subject to their control and that no part of such income was distributed to them nor accumulated for nor applied nor applicable to the discharge of their obligations.

3. In failing to determine that section 167(a)(2) of the Revenue Acts of 1932 and 1934 is unconstitutional if construed to require the taxing as petitioners' income of income of said trust, the distribution of which was not subject to their control and no part of which was distributed to nor accumulated for them nor applied nor applicable to the discharge of their obligations.

4. In failing to reverse the deficiency orders of the Board of Tax Appeals.

V.

ARGUMENT.

Point I.

Carl M. Loeb, the trustee, was possessed of a substantial adverse interest in the disposition of the trust income in question.

The principal question presented is whether Carl M. Loeb, the petitioners' father, had an interest substantially adverse to the petitioners in the disposition of the trust income.

Section 167 of the Revenue Acts of 1932 and 1934 provides:

> "(a) Where any part of the income of a trust
>
> (2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor;
>
> then such part of the income of the trust shall be included in computing the net income of the grantor."

It is the petitioners' contention that their father, Carl M. Loeb, possessed a substantial adverse interest within the intendment of the statute. This interest, it is asserted, was dual in nature. On the one hand, it was found in his untrammeled power to use the trust income to discharge his legal obligation to support his wife, and, on the other, it was explicit in the intention of the petitioners in creating the trust.

Congress has not defined the term "substantial adverse interest" as used in the statute. The Congressional purpose, however, was to block a possible means of tax avoidance by the device of vesting the power to distribute the income in some person having no stake in the trust or a

stake so insubstantial that the holder of the power would not improbably be amenable to the grantors' wishes (*Fulham* v. *Commissioner*, 110 F. (2d) 916).

The statute is aimed at immorality. A situation truly condemned and sought to be reached by it can only arise where the grantor, ostensibly relinquishing the right to income, chooses someone as trustee who will acquiesce in his wishes to the end that he may, in fact, receive or retain that which apparently he is giving away. The statute is not aimed at a trust created for a legitimate purpose obviously having no tax objective.

Whether a trust falls within the scope of the statute must be determined upon an appraisal of the trust instrument against a background of realities (*Fulham* v. *Commissioner*, *supra*); in the light of the settlors' intention in creating the trust and the course of conduct subsequent to its creation (*Commissioner* v. *Morton*, 108 F. (2d) 1005; *Henry A. B. Dunning*, 36 B. T. A. 1222; *Raoul H. Fleischmann* v. *Commissioner*, 40 B. T. A. 672).

Characterization, as indulged in by the court below, of an interest as not sufficiently "direct" avoids a decision of the question involved. For the issue is not whether one having the power to control the distribution of income is directly or beneficially interested in that income, but, rather, whether circumstances exist which would impel him, because of self-interest, to act in a manner detrimental to the interest of the settlor. Stated otherwise, the only question to be answered in a case arising under the section here involved, is whether a grantor has retained the controlling hand over the income which he appears to have given away.

The trustee here, the father of the settlors, was given the unrestricted right to distribute the trust income either to his wife, to whom he owed the legal obligation of support, or to any or all of his children. The record shows that in one taxable year under review there was no distribution

because there was no net income, and in the other year he distributed approximately $25,000 to his wife (sufficient for maintenance of the household and for personal expenses), $20,000 to a married daughter, and $5,000 to one of the settlors. To the other settlor he distributed nothing. The record also shows that the very purpose underlying the creation of the trust was to endow the father with an unrestricted right to distribute the income to his wife and to such of his children as, in the exercise of his sole and uncontrolled judgment, he should deem proper.

To suggest that the settlors, who had only recently attained their majority, one of who was "on allowance", who had created the trust at the dictation of their father and given him unrestricted control over the corpus and income, either did or could expect their father to be amenable to their desires, is indeed to close the mind to the realities. To retain such a notion in the light of what the father actually did with the income of the trust, is to replace fact with fancy. To deny that the father had an interest adverse to the grantors and that it was substantial, is to deny obvious facts.

That the trustee, vested with the power to distribute income to his wife, would be likely to exercise that right, was recognized by the Circuit Court. It viewed the petitioners' argument that this right was adverse to the interest of the grantors as having some "persuasive force", but concluded that such an adverse right was not sufficiently direct to bring it within the contemplation of the statute. The reasoning by which it arrived at this conclusion is not persuasive. A substantial adverse interest, said the court, is an interest sufficiently direct and adverse to rebut the presumption that the grantors can control, in fact, the exercise of discretion vested in another, but proof that the grantors would actually have no control over his exercise of discretion is not decisive unless it can be shown that such

a person has a substantial adverse interest. This, of course, is an endless chain of reasoning which leads nowhere.

The conclusion of the court that a substantial adverse interest must be a direct interest, is in conflict with the decisions of sister courts and of the Board of Tax Appeals.

The question was considered in *Savage* v. *Commissioner*, 82 F. (2d) 92, arising under the 1928 Act, which taxed to a grantor the income of a trust where the grantor alone, or in conjunction with any person not a beneficiary, had the right to revest in himself title to any part of the corpus of the trust. The wife had created a trust under which the income therefrom was payable to her husband for the support, maintenance and education of their children, and reserved the right of revocation, but only with the consent of her husband. The Commissioner taxed the trust income to the wife and the Board sustained his determination on the ground that the trust was not created for the benefit of the husband, that he had neither a vested nor contingent interest in the trust property or income and, hence, that he was not a beneficiary.

The Court of Appeals for the Third Circuit, however, reversed the Board and held that the husband was a beneficiary of the trust in that it made possible the maintenance of a home for him and his children, for which, under the law, he was responsible, and, hence, substantially benefited him.

In *Helvering* v. *Hormel* (111 F. (2d) 1, cert. granted Oct. 14, 1940), the Circuit Court of Appeals for the Eighth Circuit held that a wife to whom trust income was paid as guardian of her minor children for their use and benefit, had a substantial adverse interest to that of her husband in the income of the trust. Her interest, of course, was not a direct one, but because of her duty to her children it was held to be substantial and adverse to that of the settlor within the intendment of the statute. Similar determina-

tions are found in *Raoul H. Fleischmann* v. *Commissioner*, 40 B. T. A. 672, in which the Commissioner has announced his acquiescence; *Freda R. Caspersen* v. *Commissioner*, 40 B. T. A. 759, and *Olive H. Prouty* v. *Commissioner*, 41 B. T. A. 277.

Our research has uncovered no decision, either of court or Board, holding, as does the court below, that a substantial adverse interest in either principal or income of a trust must be a direct interest therein. The rule enunciated in this case is supported neither by authority nor by reason, and in the interest of taxpayer and government alike, the confusion should promptly be resolved.

Point II.

Section 167(a)(2) of the Revenue Acts of 1932 and 1934 is unconstitutional if it be construed to require taxation to the grantor of trust income which is neither distributed to nor accumulated for him nor applied nor applicable to the discharge of his obligations, and the distribution of which is not subject to his control.

Congress has the power to adopt means fairly and reasonably calculated to prevent the avoidance of taxation. Nevertheless, the provisions of the statute adopted may be so arbitrary and capricious as to amount to confiscation and thereby offend the Fifth Amendment to the Constitution (*Heiner* v. *Donnan*, 285 U. S. 312). There are limits to the power of Congress to create a fictitious status under the guise of supposed necessity (*Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85).

The decision of the Supreme Court in *Hoeper* v. *Tax Commission*, 284 U. S. 206, holding a statute unconstitutional which attempted to levy a tax on a husband, based upon the combined income of both husband and wife, points to the unconstitutionality of Section 167(a)(2) if construed

to compel taxation to the petitioners of income of the trust actually distributed to others. To the same effect are *Schlesinger* v. *Wisconsin*, 270 U. S. 230, and *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, and the dissenting opinion in *Charles H. Mott* v. *Commissioner*, 30 B. T. A. 1040.

Conclusion.

It is respectfully submitted that these cases call for the exercise by this Court of its supervisory powers in order that the construction and constitutionality of the Federal statutes involved be definitely determined and the errors of the Circuit Court of Appeals for the Second Circuit be corrected, and that, to such end, writs of certiorari should be granted and the court should review the decisions of the Circuit Court of Appeals for the Second Circuit and finally reverse it.

Dated, October, 1940.

Arthur B. Hyman,
Counsel for Petitioners.

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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 527

CARL M. LOEB, JR., PETITIONER

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 528

HENRY A. LOEB, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 25–28) is reported in 40 B. T. A. 517. The opinion of the Circuit Court of Appeals is reported in 113 F. (2d) 664.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered August 5, 1940. (R. 98–99.) The petition for writs of certiorari was filed October 26, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayers, Carl, Jr., and Henry Loeb, created a trust, naming their father as trustee with discretionary power to distribute the net income at the end of each year to the grantors or their mother, sister or brother. The question presented is whether the grantors are taxable under Section 167 of the Revenue Acts of 1932 and 1934 on the entire trust income for 1933 and 1934. The answer to this question depends upon whether the father had a "substantial adverse interest" in the trust income within the meaning of Section 167.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 9–13.

STATEMENT

The facts found by the Board of Tax Appeals (R. 22–25), are as follows:

Carl M. Loeb had created a trust, or trusts, for his four children prior to 1918. He and his wife were trustees. A share of the corpus was distributable to each child in the discretion of the trustees

after the child reached majority, but was to be distributed not later than when the child reached forty. Carl told his sons Carl, Jr., and Henry, in 1928, that the shares of Margaret and John had been distributed to them several years previously, and thereafter the remaining trust corpus had increased to such an extent that the shares left for Carl, Jr., and Henry were much larger than the shares distributed to Margaret and John, so he requested Carl, Jr., and Henry to create a trust of their shares to benefit their mother, their sister, their brother, and themselves. Carl, Jr., and Henry were then of age. They received their shares of the old trust and used that property to create a new trust. (R. 22, 54–55, 57.)

The new trust was created on January 16, 1929. (R. 44–52.) They made their father the sole trustee and provided that he should pay the income of the trust at the end of each year to one or more of the following beneficiaries in such proportions as he in his absolute discretion might choose (R. 22–23, 41, 44–45):

(1) Adeline L. Loeb, wife of Carl and mother of the grantors
(2) Margaret L. Kempner, sister of the grantors
(3) John L. Loeb, brother of the granters
(4) Carl M. Loeb, Jr. } the grantors
(5) Henry A. Loeb }

or the surviving descendants of any of the above who should die during the continuance of the trust

(R. 23, 41, 45). The trustee was given possession and control of the trust corpus. (R. 23, 48–49.)

The trust was irrevocable and was to continue until the death of the father, when the corpus was to be divided equally among the three brothers and their sister. (R. 23, 44–46.) A successor trustee could be appointed under certain circumstances, but he was required to distribute the annual income equally among the three brothers and their sister.[1] (R. 23, 44, 45–57.)

The trust continued through 1935 and during that period the distributions of annual income were as follows (R. 23, 39–40, 56–57, 59):

	1929	1930	1932	1934	1935
Adeline		$40, 560. 90	$15, 362. 00	$24, 892. 22	$52, 550. 92
Margaret				20, 000. 00	52, 550. 92
John	$39, 791. 05				
Carl, Jr	79, 582. 11				
Henry	79, 582. 11			5, 000. 00	52, 550. 91

No distributions were made of any income for 1931 and 1933. (R. 24, 38, 57.)

Carl M. Loeb, his wife, their daughter, Margaret, and their son, John, each had a substantial estate created by Carl M. Loeb. The following table shows their income for 1933 and 1934 (R. 24, 41–43):

[1] Although the Board so found, the record indicates that the mother would also be entitled to a distributive share. (R. 45.)

1933

	Income	Capital losses	Total
Carl	$209, 232. 23	$144, 115. 09	$65, 117. 14
Adeline	6, 066. 38	41, 629. 77	−35, 563. 39
Margaret	20, 987. 89	14, 049. 90	6, 937. 99
John	162, 071. 18	253, 216. 62	−91, 145. 44

1934

	Income	Capital gains	Capital losses	Trust distribution	Total
Carl	$152, 448. 98	$10, 550. 80			$162, 999. 78
Adeline	6, 184. 46		$5, 324. 25	$24, 892. 22	25, 752. 43
Margaret	14, 932. 47	3, 884. 92		20, 000. 00	38, 817. 39
John	112, 672. 30	28, 654. 46			141, 326. 76

Margaret and John were married and lived apart from their parents. Carl M. Loeb always maintained his family upon a scale of living consistent with his means. He paid annual rent for summer and winter homes during 1933 and 1934 in the amount of $17,000. The living and household expenses of Loeb and his wife exceeded $25,000 annually in addition to the rent. The distributions received by Adeline and her separate income were used to defray all household and personal expenses except rent. (R. 24, 42.)

The income of the trust for the years 1933 and 1934 was as follows (R. 25, 38–39):

Year	Ordinary income	Dividends	Capital net loss
1933	$31, 769. 79	$33, 957. 00	$72, 392. 72
1934	36, 129. 53	31, 464. 98	

The Commissioner in determining the deficiencies included one-half of the above items in computing the income of the two grantors, less, however, in the case of Henry A. Loeb, the sum of $5,000 actually distributed to him during the year 1934 and reported by him in his return for that year. (R. 25, 38–39, 84–85.)

Upon review, the Board of Tax Appeals sustained the Commissioner and the court below has affirmed the decisions of the Board.

ARGUMENT

The grantors, Henry and Carl, Jr., were taxable under Section 167 (a) (2), which provides that where any part of the income of a trust "may, in the discretion of the grantor or of any person [their father] not having a substantial adverse interest" in the disposition of such income, be distributed to the grantor, then such income shall be taxed to the grantor. The sole question in this case is whether the father had a "substantial adverse interest" in the income. If he did not, then the foregoing provisions unambiguously require that the grantors be charged with the income in question.

It is undisputed that the father had no interest as such in the income in question. Petitioners' sole basis for urging that he did have a substantial adverse interest in the income is that the father could have allotted the income to his wife whom he was legally obligated to support. But the short answer to that contention is that, under the trust instru-

ment, she would not be required to use it for her support.[2]

The decision below is correct, and there are no conflicts warranting further review.

Helvering v. *Hormel*, 111 F. (2d) 1 (C. C. A. 8th), certiorari granted, No. 257, present Term, involves primarily a question relating to scope of review in the circuit courts of appeals, and the tax in that case was sustained upon the basis of *Helvering* v. *Clifford*, 309 U. S. 331, which rests upon different statutory provisions.[3]

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[2] Compare *Hill* v. *Commissioner*, 88 F. (2d) 941 (C. C. A. 8th), where a husband created a trust (1) to pay $12,000 a year to his wife, and (2) to pay such amounts as may be necessary for her support and the maintenance of their family home. No tax was imposed upon him with respect to the $12,000, since it was not necessarily directed towards the discharge of an obligation; but the amounts paid to her under the second provision were attributed to the husband for income tax purposes.

[3] The Government had unsuccessfully contended in the circuit court of appeals in the *Hormel* case that the grantor was taxable under Section 167 as well. There the taxpayer had created a trust to pay certain income to his wife who was to expend it for the benefit of their children. The Government had contended that since such income might be used for the support of those children the father would be relieved *pro tanto* of an obligation, and that he was therefore taxable under Section 167 (a) (2). The theory was that the use of the income for his children was equivalent to a distribution to him under Section 167. In deciding that the father was not taxable under Section 167, the court in the *Hormel* case held, erroneously we believe, that the wife by reason of her position as guardian and by reason of her supposed duty under applicable state law to account for the income in question, had a "substantial adverse interest". No such situation is here presented.

Nor is *Savage* v. *Commissioner,* 82 F. (2d) 92 (C. C. A. 3d), in conflict with the decision below. That case did not involve the interpretation of the critical statutory language in the present case ("substantial adverse interest"). The opinion merely intimated that the grantor's husband might be taxable because the trust income was distributable to him to be used by him in discharge of his obligation to support his minor children. In the instant case there is plainly no provision authorizing the father to employ the income in satisfaction of his legal obligations.

CONCLUSION

The decision below is correct. There is no conflict with any decision in any circuit court of appeals. The petition should be denied.

Respectfully submitted.

Francis Biddle,
Solicitor General.

November, 1940.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; * * *

* * * * *

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question".

The corresponding provisions of Section 167 of the Revenue Act of 1934, c. 277, 48 Stat. 680 (U. S. C., Title 26, Sec. 167), are the same as the foregoing.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 881. *Income of trusts taxable to grantor.*—In the case of certain trusts

which are in whole or in part subject to revocation by the grantor or by any person not having a substantial adverse interest, or which are for the benefit of the grantor, the income of the trust is to be included in computing the net income of the grantor. The income of such trusts must be so included, whether or not the trust was created before the enactment of the Revenue Act of 1932. * * * The grantor shall include in his income the entire gross income of such part of the trust, and shall be entitled to such deductions with reference to such income as he would have been entitled to if the trust had not been created. * * *

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As used in this article, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question," and the term "substantial adverse interest" means "substantial interest in the trust adverse to the grantor."

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

> Art. 167-1 [as amended by T. D. 4759, 1937-2 Cum. Bull. 117, and T. D. 4860, 1938-2 Cum. Bull. 184]. *Trusts in the income of which the grantor retains an interest.* — (*a*) *Scope.* — Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income*

of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(*b*) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, both permanently and definitely, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) when the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitively of every such interest retained by him, the income of the trust realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(*c*) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled had such income been distributable currently to him.

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